



11 o'clock files

Simply Trade related P3 tips

Comparative advantage questions

You may be asked to calculate the opportunity cost of producing a specific good → data will be given on how much an economy can produce with available resources

- Remember → the opportunity cost of producing good X is the number of units of good Y that need to be sacrificed to produce a unit of X: $OC(X) = \frac{\Delta Y}{\Delta x}$

Assume a country can produce with a unit of labor 120 kilos of lentils (and 0 kilos of peas) or 180 kilos of peas (and 0 kilos of lentils)

- The OC of producing lentils is 180/120 kilos of peas, i.e. 1.5 kilos of peas (i.e. $\frac{180-0}{0-120} = -1.5$, where the minus sign reflects the idea of 'sacrifice' (cost)
- Of course, the OC of producing peas is 120 / 180 kilos of lentils or 2/3 kilos of lentils (always the inverse)
- Remember to include units of measurement: the OC of producing a kilo of lentils is 1.5 kilos *of peas*.
- If asked to plot the PPFs remember they are linear as the OC ratios are assumed constant
- To plot the PPFs → determine for each country the maximum amount it can produce for each good (say for lentils and for peas) → since the axes are the

two goods (lentils and peas) these numbers will be the intercepts → connect these two points → done

Tariff, quota, subsidy on a grid questions

You may be asked to calculate from diagrams the effects of imposing a tariff; ...a quota; ...a subsidy to domestic producers

- A diagram will be provided in a grid with a number of calculating questions; make sure you note the currency (\$) or (€) as well as whether the quantity is in thousands or millions or whatever
- At the world price provided by the question → draw a line parallel to the horizontal as this will be the world supply faced (if, of course, the line is not already drawn in the question)
- Perhaps, sketch on a page of the answer booklet the appropriate diagram to denote areas etc. and get a clearer picture of what is going on
- Remember that change is → (New – Old) or, $\Delta X = (X_2 - X_1)$
- Remember → trapeziums result from *changes* in consumer/producer surpluses; their area is → $\frac{B+b}{2} \times h$
- Remember → little triangles reflect the production and consumption inefficiencies; the area of a triangle is → $\frac{B \times h}{2}$
- All quantity related answers are in the quantity units provided (e.g. kilos; thousands)
- All monetary answers are in the currency unit (dollars etc.) but note whether these are thousands or millions...

If it is a tariff question

- If a tariff is imposed → draw a line parallel and *above* the world supply → vertical distance is the size of the tariff (count on the grid the 'steps' and be careful) → label the new domestic price (as P_T) and the new supply curve faced (S_t)
- If a tariff is withdrawn → draw the world supply as a line parallel and *below* the tariff 'line' → the vertical distance is the size of the tariff withdrawn (count on the grid the 'steps' and be careful) → label the new price (as P_w) and the new supply curve faced (S_w)

If it is a quota question

- If a quota is imposed → draw a line parallel and *to the right of the domestic upward sloping supply curve* → horizontal distance is the size of the quota (count on the grid the 'steps' and be careful) → label the new domestic supply (as $S_{d+quota}$)
- If a quota is withdrawn → ignore any provided $S_{d+quota}$ curve and work with the horizontal world price

If it is a subsidy question

- If a subsidy to domestic producers is paid → draw a new supply curve parallel and *below* the supply curve in the grid → the vertical distance is the subsidy (count on the grid the 'steps' and be careful)
- In a subsidy diagram remember that the price consumers pay is still the world price but the price producers earn is whatever consumers pay (i.e. the world price) *plus* the subsidy → from the new greater equilibrium quantity raise the line all the way to the original supply curve → take a left towards the vertical to find this new price producers earn

Exchange rate questions

- If asked to calculate the equilibrium exchange rate → just like solving D & S micro questions on P and Q determination
- If asked to calculate the price of a good in a different currency → multiply the price in the original currency by the number of units of foreign currency one unit of the domestic currency buys → e.g. if the price of a textbook in euro is €44.50 and you are asked to calculate it in dollars when €1.00 = \$1.09 → multiply 44.50 by 1.09 to get \$48.505 → remember to round-off to 2 decimal places → \$48.51 is the answer
- If you are asked to determine the percentage change in the value of a currency → remember the $\frac{(N-O)}{O} \times 100$ 'formula'
- If you are given an initial exchange rate and told that the currency appreciated by, say, 3.7% then the new exchange rate is the old one times 1.037 → if in the example above the euro appreciated by 3.7% then the new exchange rate is $1.09 \times 1.037 = \$1.13033$; round-off to \$1.13 if this is the final calculation but don't if there are further calculations using the new exchange rate.
- If you are given an initial exchange rate and told that the currency depreciated by, say, 3.7% then the new exchange rate is the old one times $(1-0.037)$ → using the example above → if euro depreciates by 3.7% → new e.r. is $1.09 \times (1 - 0.037) = 1.04967$ or 1.05 if no further calculation using this new er is expected.
- Remember if X increases by 4.7% then $X' = X + 0.047X = 1.047X$
- Remember if X decreases by 4.7% then $X' = X - 0.047X = (1-0.047)X$
- Remember to stick to the 2 decimal places rule (but apply it at the last step in any calculations)

TOT questions

- TOT is an index number → no units of measurement
- $TOT = \frac{P_x}{P_m} \times 100$, where P_x → average price of exports and P_m → average price of imports → both expressed as index numbers (that's why it is times 100)
- To calculate the TOT → apply the formula above → rem to multiply by 100
- The value of any variable expressed in index number form in period t is its value in t over its value in the base year times 100 → that's why the base year value is always 100
- If TOT rises → favorable movement (an improvement)
- If TOT drops → unfavorable movement (a deterioration)